APPENDIX

IN THE UNITED STATES COURT OF CLAIMS

No. 145-59

(Decided March 7, 1962)

GENERAL ELECTRIC COMPANY

v.

THE UNITED STATES

John P. Lipscomb, Jr., for plaintiff. *Floyd F. Toomey, C. Rudolf Peterson,* and *James McCarthy* were on the briefs.

Philip R. Miller, with whom was *Assistant Attorney General Louis F. Oberdorfer*, for defendant. *Lyle M. Turner, Joel N. Simon, Harold S. Larsen,* and *Mildred L. Seidman* were on the brief.

Opinion

WHITAKER, *Judge*, delivered the opinion of the court:

This is a suit for the recovery of income taxes paid for the calendar years 1949 through 1953.

Plaintiff included in its income tax returns for the years involved the capital gains derived from the disposition of certain shares of its common stock which plaintiff had acquired, in part, in a liquidation of its wholly-owned subsidiary, in part as dividends in kind, and in part by purchase, and which, after acquisition, it had held in its treasury. Thereafter, plaintiff, having concluded this was erroneous, filed claims for refund for those years, on the ground that the dispositions of its stock did not give rise

to taxable gains. The Commissioner of Internal Revenue disallowed the claims for refund and this suit followed.

Plaintiff is a New York corporation engaged primarily in the business of manufacturing and selling electrical appliances and equipment. During the years pertinent to this litigation, plaintiff had a capitalization of 35,000,000 shares of voting common stock of no par value, approximately 29,000,000 of which were issued and outstanding. Its common stock was listed and actively traded on the New York Stock Exchange, ranging in price from a low in 1942 of $21.50 a share to a high in 1953 of $92.25 a share.

Plaintiff also had authorized, but unissued, 1,207,036 shares of $10 par value 6 percent cumulative special stock. Only plaintiff's common stock is involved in this action.

In 1948, 475,800 shares of plaintiff's common stock were owned by G. E. Employees Securities Corporation, a wholly owned subsidiary of plaintiff, organized and operated for the purpose of providing a medium for the investment of the savings of plaintiff's employees. By that time, in 1948, economic conditions had so changed that Employees Securities could no longer function as a medium of investment for employee savings and, hence, a plan for the complete liquidation of this corporation was adopted. Pursuant to the plan of liquidation, the stock in Employees Securities held by plaintiff was transferred to Employees Securities and was cancelled, and the 475,800 shares of plaintiff's common stock, together with other assets held by Employees Securities, were distributed to plaintiff.

At the time of the liquidation plaintiff was not required to report any gain on the difference between the cost to it of the Employees Securities stock and the fair market value of the property received in the liquidation. However, the basis for the gain derived by plaintiff from the disposition of the assets received from Employees Securities was the same in its hands as it was in the hands of Employees

Securities. Internal Revenue Code of 1939, § 113(a)(15), 26 U.S.C. § 113(a)(15). Plaintiff so reported it in its income tax returns.

Some time prior to 1949, plaintiff had adopted a plan of paying additional compensation to its executives and other supervisory personnel, known as the "Extra Compensation Plan", under which the directors were empowered to pay to such employees an amount not in excess of 8 percent of the balance of the earnings for each year after deducting 8 percent on plaintiff's average investment. The plan was administered by a committee appointed by the board of directors from among its own members. Certain selected managerial employees were to receive one-half the amount allotted to them in cash, and the other half in plaintiff's common stock. As to the remainder, the committee was given absolute discretion to determine whether the employees concerned were to be paid wholly in cash or partly in cash and partly in plaintiff's common stock or in other securities. As it turned out, substantially all awards made under the plan during the period 1936 through 1953 were paid approximately one-half in cash and one-half in plaintiff's common stock.

In addition to the distributions of shares of its common stock under the Extra Compensation Plan during the years 1936 through 1953 plaintiff made further distributions of shares of its common stock to certain of its sales managers and other employees who had performed outstanding services but who did not participate in the Extra Compensation Plan.

Each of plaintiff's employees receiving shares of stock as additional compensation was informed by letter that "the stock is your property and may be retained or disposed of according to your own judgment."

In 1948, after the liquidation of Employees Securities, plaintiff established the G. E. Employees Savings and Stock

Bonus Plan to afford its employees a convenient means of investing their savings in U.S. Savings Bonds, Series E. Under this plan each participating employee authorized regular payroll deductions for the purchase of savings bonds. The bonds so purchased were deposited with plaintiff and, after a specified holding period, they were delivered to the employee or employees concerned together with an amount of plaintiff's common stock equal to 15 percent of the cost of the savings bonds purchased by the employees. The plan was administered by a trust set up by plaintiff in 1949. The trust received and held the bonds and shares of plaintiff's common stock, collected and invested the dividends received on the stock, and then at the appointed time delivered the shares and the income accumulated thereon to the person or persons entitled thereto.

Besides the foregoing distributions of plaintiff's common stock to its own employees, plaintiff sold, at the market price, during the years 1949 through 1953, approximately 42,000 shares of its common stock held in its treasury to certain affiliated corporations for use by those corporations under their own extra compensation and stock bonus plans.

The dispositions of treasury stock to plaintiff's employees and to its affiliates for distribution to their employees during the taxable years involved is summarized in the following table:

Taxable Year	Extra Compensation, in Shares	To Stock Bonus Trust, in Shares	Commissions, in Shares	Sales to Affiliates for Their Stock Bonus and Extra Compensation Plans in Shares
1949	49,227	19,537.67	1,082	9,864.33
1950	40,097	78,537.09	618	10,256.91
1951	51,434	46,944.54	942	10,901.46
1952	43,428	39,485.76	924	7,867.24
1953	42,372	43,142.35	603	2,865.65

During 1949, 1952 and 1953, plaintiff distributed 54,000 shares of its treasury stock to charitable institutions in addition to the other uses it made of the stock.

The only other distributions of plaintiff's treasury stock with which we are concerned occurred in 1953. These were small in amount and are as follows: 508 shares were paid to employees who had filed patent applications covering inventions made by them; 200 shares were paid to selected employees as honorariums for outstanding services; 950 shares were transferred in trust for children of employees who were born on October 15, 1953, plaintiff's 75th anniversary; 7,747 shares were used to acquire certain minority shares of stock outstanding of Canadian General Electric Company, Limited, a corporation of which plaintiff owned 96 percent of the outstanding shares.

All total, plaintiff disposed of more than 560,000 shares of its common stock held in its treasury during the period January 1, 1949, through December 31, 1953, in the manner described.

On January 1, 1949, the first of the taxable years in issue, plaintiff held in its treasury, 497,778.36 shares of its common stock. Of these, 475,800 were the shares received in the 1948 liquidation of Employees Securities Corporation. In addition to these shares, plaintiff had received as dividends in kind on its Employees Securities stock, 12,278 shares of its own stock. The remaining 9,700.36 shares plaintiff had purchased on the open market.

Subsequent thereto, and from January 1, 1949, to December 31, 1953, plaintiff purchased on the open market some 332,000+ additional shares of its common stock, acquired a small number of additional shares from the stock bonus trust and received approximately 6,000 shares in the merger or liquidation of affiliated corporations. (See Finding 43 for a detailed schedule of plaintiff's stock acquisitions.)

None of the stock which plaintiff acquired was retired but was held by plaintiff as treasury stock and was carried on plaintiff's books as a charge to an asset account entitled "G.E. common stock reacquired." In the report to its stockholders and in its income tax returns it was carried as an asset under the heading of "investments". This typical comment about it was made in a note on the balance sheet accompanying the report to the stockholders:

> Note 9. General Electric common stock in the portfolio was held for corporate purposes and was carried at its cost. There were 159,335 shares held on December 31, 1952, the aggregate quoted market value of which was $11,591,595.

All distributions of plaintiff's common stock in question were made from this account. While held by plaintiff as treasury stock, none of it had voting rights and no dividends were paid on it.

For each of the years 1949 through 1953, plaintiff paid a tax on the difference between the cost or basis of the common stock held in its treasury and disposed of in such year and the fair market value of the shares at the time of disposition. Plaintiff says it is entitled to a refund of these taxes because it realized no taxable gains on their disposition.

Whether a corporation realizes income or gain on the sale or other disposition of treasury stock has been the subject of considerable litigation. Whether it does or not depends, in our opinion, on the facts of the particular case. Under the facts of this case, we think plaintiff did realize gains.

Section 22(a) of the Internal Revenue Code of 1939, 26 U.S.C. § 22(a), required the inclusion in gross income of "gains or profits and income derived from any source whatsoever," but this does not answer our question. Our question is, does a corporation which buys or otherwise

acquires its own stock and then sells it or otherwise disposes of it realize gains, profits, or income from such a transaction?

Until 1934 the treasury regulations in effect under prior revenue laws provided that a corporation realized no gain or loss from the purchase or sale of its own stock. See *e.g.* Treasury Regulation 77, Art. 66. But, as the result of the decision of the Court of Appeals for the First Circuit in *Commissioner* v. *A. S. Woods Machine Co.*, 57 F. 2d 636, *cert.* denied, 287 U.S. 613, the regulations were amended on May 2, 1934. T.D. 4430 [XIII-1 C.B. 36]. These regulations, as amended, were continued in force as section 29.22(a)-15 of Treasury Regulation 111, applicable for all years involed in this case through 1951, and, since then, as section 39.22(a)-15 of Regulation 118, applicable to the years 1952 and 1953. Section 29.22(a)-15 of Regulation 111 provides:

> Sec. 29.22(a)-15. *Acquisition or Disposition by a Corporation of its Own Capital Stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> *But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it,*

> *or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property.* Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code. [Emphasis supplied.]

These regulations remained in force and effect from their adoption in 1934 until the adoption of the Internal Revenue Code of 1954. As we have said, they had their genesis in the decision of the Court of Appeals for the First Circuit in *Commissioner* v. *Woods Machine Co., supra.* In that case the corporation received shares of its own stock in satisfaction of its claim for infringement of one of its patents. The Commissioner of Internal Revenue had assessed a tax on the gain derived from the transaction. The Board of Tax Appeals—six members dissenting—had held that no gain had been realized, but the Court of Appeals reversed. It said:

> Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involed. * * * If it was in fact a capital transaction, i.e., if the shares were acquired or parted with in connection with a readjustment of the capital structure of the corporation, the Board rule applies. * * * But where the transaction is not of that character, and a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the taxable income. The view taken by the Board of Tax Appeals * * * presses accounting theory too far in disregard of plain facts. * * *

Following this decision the regulations were changed to read as quoted, *supra*.

As changed, they have been held to be valid by the Courts of Appeals for the Second, Third, Sixth, Seventh and Eighth Circuits, by the Board of Tax Appeals, and by this court. See *Commissioner of Internal Revenue* v. *Air Reduction Co.*, 130 F. 2d 145 (Second Circuit); *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474 (Second Circuit); *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939 (Third Circuit); *Commissioner* v. *Landers Corp.*, 210 F. 2d 188 (Sixth Circuit); *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698 (Seventh Circuit); *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575 (Eighth Circuit); *Brown Shoe Co.* v. *Commissioner*, 45 B.T.A. 212, affirmed 133 F. 2d 582. This court sustained their validity in *Wiegand* v. *United States*, 104 Ct. Cl. 111.

They were impliedly upheld by the Supreme Court in *United States* v. *Anderson, Clayton & Co.*, 350 U.S. 55. At pp. 58-59 the Court said:

> * * * The amended regulation specifically excludes from tax consequences a corporation's sale of its stock upon original issue whether sold for more or less than par or stated value. On the other hand, the regulation specifically provides that tax consequences flow from the receipt by the corporation of its own stock as consideration for sales of its property or in satisfaction of indebtedness to it. With regard to all other dealings by a corporation in its own stock, whether or not tax consequences result depends generally upon the "real nature of the transaction, which is to be ascertained from all its facts and circumstances." The regulation provides further that "if a corporation deals in its own shares as it might in the shares of another corporation," such dealings are considered, for tax purposes, as though the corporation were in fact dealing in the other corporation's stock. Thus, whether

the transaction here in question is taxable depends, in the final analysis, on whether respondent corporation dealt with its shares of treasury stock "as it might" have dealt with another corporation's stock.

The decision in that case assumed the validity of the regulations. It held for the taxpayer because it was of opinion that the transaction under scrutiny did not come within their terms.

Congress impliedly approved them in the Revenue Act of 1936 and in the Revenue Code of 1939, providing for the determination of the dividends paid credit to be taken in computing the surtax on undistributed profits, by differentiating between a stock dividend and a dividend payable in the stock of a corporation held for investment. Section 27 of the Internal Revenue Code of 1939 reads, in part, as follows:

> (d) *Dividends in Kind.*—If a dividend is paid in property other than money (*including stock of the corporation if held by the corporation as an investment*) the amount with respect thereto which shall be used in computing the basic surtax credit shall be the adjusted basis of the property in the hands of the corporation at the time of payment, or the fair market value of the property at the time of the payment, whichever is the lower. [Emphasis supplied.]
>
> • • • • •
>
> (f) *Taxable Stock Dividends.*—In case of a stock dividend or stock right which is a taxable dividend in the hands of shareholders under section 115(f), the amount with respect thereto which shall be used in computing the basic surtax credit shall be the fair market value of the stock or the stock right at the time of the payment.

However, when Congress adopted the Internal Revenue Code of 1954, it decided to exclude from gross income any

gain or loss in an exchange of treasury stock for money or other property; but there is no intimation that this provision was intended to be retroactive. (Internal Revenue Code of 1954, § 1032, 26 U.S.C. § 1032.) Prior to the Internal Revenue Code of 1954, the law was as stated in the regulations quoted, *supra*.

Our problem, then, is to determine whether plaintiff's dealings in its own stock, as outlined above, come within the terms of the regulations.

Under some circumstances, it is true, that a corporation's own stock held in its treasury is not an asset. Upon acquisition of it, absent an intention to use it as other property, the corporation's equity capital is reduced by the amount of it. But, where a corporation acquires it for the purpose of holding it temporarily and later using it as it might use the stock of another corporation, or as it might use cash, it would seem that it is of the same character as any other stock the corporation might acquire. In such case, the corporation's equity capital is not in fact reduced, because the treasury stock is earmarked for future disposition. It is somewhat in the same status as other outstanding stock while held in the treasury pending its disposition for a particular purpose, such as, *e.g.*, for the purpose of discharging an obligation incurred or likely to be incurred.

This would seem to be the reason for the differentiation made by the regulations between an original issue of stock and a corporation's stock in which it deals as it might in the shares of another corporation. When the corporation acquires such stock, it has no intention of reducing its capital; it holds it in its treasury only until the time arrives for its foreordained disposition.

The regulations describe three transactions in which gain or loss results when a corporation deals in its own stock: (1) where it deals in it as it might in the shares of another corporation; (2) where it sells property and receives stock

as the consideration for it; and (3) where it receives its stock in satisfaction of a debt.

We are of opinion that plaintiff's transactions come within both the first and second of the kinds of transactions mentioned. As to the second kind, when plaintiff merged with or liquidated its subsidiaries it received its own stock in consideration of the transfer to its subsidiary of its stock holdings in the subsidiary. While the transaction does not come within the letter of this portion of the regulations, it does come within the principle of them. We think its merger with or liquidation of its subsidiaries should be treated as a sale of its stockholdings in the subsidiary for the subsidiaries' assets, which included stock in plaintiff.

We are further of the opinion that plaintiff dealt in its own stock as it might have in the stock of any other corporation, that is to say, it was engaged in the enterprise of acquiring it for the purpose of using it in the discharge of its obligations, in lieu of the payment of them in cash or using other stock to discharge them. Let us see if this is so. First, how did plaintiff acquire the stock?

Of the shares in question, 475,800 were received by it on the liquidation of its subsidiary, Employees Securitites. When this stock was received plaintiff set it upon its books as an asset. There was a reason for this, as we shall see. It could have retired it and reduced its capital by the amount of it, but this was not done. Instead, plaintiff carried it on its books as an asset.

53,200 shares were received as dividends in kind, declared by plaintiff's subsidiaries who had held shares of plaintiff's stock. The findings show these dividends were declared in kind, rather than in cash, because plaintiff had a use for them, and wanted them declared this way. They were set up on its books as an asset.

332,000 + shares were purchased on the open market. These also were set upon the books as an asset.

All of these shares were carried on plaintiff's books as assets because plaintiff needed them for several purposes. It needed them for use in connection with its Extra Compensation Plan, described above. Some of its employees coming under this plan were to receive their extra compensation, one-half in cash, and one-half in plaintiff's stock. The other employees might be paid either in cash or in stock as the committee might decide. It disposed of 227,641 shares in this manner.

It needed these shares for use in connection with its Extra Incentive Compensation Plan. It disposed of 226,558 shares in this manner. It used 4,169 shares to pay commissions.

It sold to certain of its affiliates 41,755.59 shares, which they used in connection with their incentive compensation plans.

It gave away 54,000 shares as charitable contributions.

The sales to its affiliates were at the market price, whatever the price at which plaintiff had acquired them. The donations to charity were deducted from income at the market price, whatever the price plaintiff had paid for them. The extra compensation paid its employees were deducted from income at the market price of the stock, irrespective of what plaintiff had paid for them. The 475,800 shares acquired from Employees Securities in 1948 had cost that company $6,636,557.50. When they were disposed of by plaintiff, their market value was between $15,000,000 and $20,000,000.

Plaintiff realized a gain on its acquisitions and dispositions of its stock in the sum of $11,265,008.84. Huge a company as plaintiff was, it can hardly be supposed that profits on the transactions were of no consideration.

Plaintiff wants to be relieved of paying a tax on the gain in spite of the fact that it deducted their increased market value from income as an expense.

In plaintiff's hands these shares were the equivalent of cash. The allotments under the Extra Compensation Plan were payable either in cash or stock. If no stock, all cash. The stock was given in lieu of cash. In the hands of the recipients, it was equivalent to cash, since it could be sold at any time.

Had not the stock been given as charitable contributions, it would have been necessary to pay them in cash.

It used its stock as an added incentive to get its employees to save their money and buy United States Savings Bonds.

It seems to us the plaintiff used its stock as the equivalent of cash, or as it might have used the stock of any other corporation.

We are of opinion that plaintiff dealt in its stock as it might have in the stock of another corporation, with this sole exception, that only its own stock could serve a part of its purpose, to wit, of giving its employees an interest in the company, if they chose to retain the stock, instead of converting it into cash. Stock in any other corporation, however, would have served the other part of its purpose equally well, that is, to give its employees a dollar value of extra compensation. Also, the stock of any other corporation would have served equally well for making a charitable contribution, and perhaps as well for use by its subsidiaries to whom it sold its stock.

Plaintiff used its stock in lieu of cash. Such a use is within the meaning of the regulations. Whether it be in lieu of cash or in lieu of stock in another corporation, matters not.

But plaintiff says we held to the contrary in *Hercules Powder Co.* v. *United States,* Ct. Cl. Nos. 135-57, 152-58 and 318-58, decided February 3, 1960. The facts in that case and in this one are closely alike, but every case must be decided on its own facts. The majority in the *Hercules*

Powder Company case thought the facts of that case did not bring it within the regulations. Chief Judge Jones and Justice Reed disagreed. They thought the facts brought the case within the regulations and, being of the opinion the regulations were valid, the case was governed by them. As we set out above, the Courts of Appeals and the Supreme Court have also upheld the validity of the regulations. We also had upheld them in the case cited, and we reaffirm that holding. The facts of the instant case, we believe, bring it within the regulations. If they do, the gains derived are subject to tax.

It is obvious that the facts of this case differ quite a good deal from those in *Anderson, Clayton & Company* v. *United States, supra.* The decision in that case is not controlling in a case such as we now have before us.

Plaintiff's petition will be dismissed.

It is so ordered.

REED, *Justice* (*Ret.*) sitting by designation; DURFEE, *Judge*, and JONES, *Chief Judge*, concur.

LARAMORE, *Judge*, dissenting:

I respectfully dissent for the reasons stated in the majority opinion in *Hercules Powder Company* v. *United States*, Nos. 135-57, 152-58 and 318-58, decided February 3, 1960.

Findings of Fact

The court, having considered the evidence, the report of Trial Commissioner Robert K. McConnaughey, and the briefs and argument of counsel, makes findings of fact as follows:

1. The petition in this proceeding was filed pursuant to the provisions of section 1491, title 28 of the United States Code, for the recovery of income taxes for the calendar years 1949 to 1953, inclusive.

2. Plaintiff is a New York corporation. Its principal place of business is at One River Road, Schenectady, New

York. At all times material here, plaintiff was engaged primarily in the business of manufacturing and selling a wide range of electrical appliances and equipment and related products. Plaintiff's books of account were maintained and its tax returns filed on the accrual basis for a taxable year ending on December 31.

3. Plaintiff's income tax returns for the calendar years 1949 to 1953, inclusive, were filed with the District Director, Albany, New York (formerly the Collector of Internal Revenue for the Fourteenth New York District), hereinafter referred to as the "District Director." Said returns disclosed income tax liabilities (including excess profits taxes), all of which were paid in quarterly installments, as follows:

Year	*Tax Liability*
1949	$67,816,951.88
1950	152,230,102.91
1951	238,369,882.14
1952	248,761,262.57
1953	303,812,165.89

4. Thereafter, on audit of said returns by the Commissioner of Internal Revenue (hereinafter referred to as the "Commissioner"), it was determined that additional income taxes (including excess profits taxes) were due from, or that credits were allowable to, plaintiff. Additional taxes were paid by plaintiff to the District Director and credits were allowed in the following amounts:

Year	*Amount of Payment (or Credit)*
1949	$3,094,843.20
1950	(1,042,100.14)
	2,227,695.68
1951	373,312.07
	61,414.65
1952	(3,484,329.24)
	1,162,572.64
1953	(2,169,896.30)
	3,396,819.76

In addition to the foregoing additional taxes paid, plaintiff paid substantial amounts of deficiency interest thereon. Timely claims for refund were filed and were denied.

5. As of January 1, 1936, plaintiff's capital structure consisted of 29,600,000 shares of authorized voting common stock of no par value of which 28,845,927 36/100 shares were issued and outstanding. In addition, plaintiff had authorized, but not issued, 1,207,036 shares of $10 par value 6 percent cumulative special stock. No changes in plaintiff's authorized or issued stock occurred from January 1, 1936, through December 31, 1953, except that on April 20, 1948, plaintiff's stockholders approved an increase in the number of authorized shares of common stock to 35,000,000 shares. At all times material here, plaintiff's common stock was listed and traded on the New York Stock Exchange.

6. From January 1923 until its complete liquidation in 1948, G. E. Employees Securities Corporation (referred to hereafter as "Employees Securities") was a Delaware corporation. All of its outstanding common stock was owned by plaintiff. It was organized and operated for the purpose of providing a medium for investment of savings of plaintiff's employees and of the employees of certain of plaintiff's affiliated corporations. Plaintiff paid in all its equity capital. From 1923 to 1941, Employees Securities issued debenture bonds, having varying terms, to participating employees of plaintiff and certain of its affiliated corporations. The bonds originally issued carried a 6 percent interest rate with a guarantee by plaintiff that as long as the purchasing employees remained in plaintiff's employ, they would receive an additional 2 percent per annum. In 1931, approximately 33,000 employees held bonds of Employees Securities. In 1933, a 5 percent bond was offered to the employees with an additional payment of either 1 percent or 2 percent, depending upon plaintiff's earnings. Later a 4 percent bond was offered and was substituted for the 6 percent and 5 percent bonds. The bonds were redeemable on demand by the employees. No bonds were

issued to anyone other than employees of plaintiff and its affiliated corporations. No bonds were issued after 1941. In that year, plaintiff commenced selling U. S. Government bonds to its employees and did not want to compete with the program of the U. S. Treasury Department. The management of Employees Securities at all times was vested in a board of directors consisting of fifteen members. Of these, eight represented the plaintiff as the sole stockholder and seven represented the bondholders.

7. When Employees Securities was formed in 1923, it was contemplated that at least 25 percent of its assets would be invested in plaintiff's common stock. Plaintiff wished to give the employees who purchased bonds an investment that would not be subject to market fluctuations, as well as an indirect interest in the company for which they worked. In 1931, Employees Securities owned slightly over 500,000 shares of plaintiff's common stock. Originally, the remainder of its capital was invested in securities of electric public utilities. In 1933, and as a consequence of the depression, Employees Securities shifted a portion of its investments to industrial securities. The investment policy of Employees Securities was to obtain security of principal and regularity of income rather than appreciation in principal.

Decisions to make or change investments were made by the officers of Employees Securities. Such decisions were not dictated by the management of the plaintiff, and the record contains no evidence that plaintiff's management made any effort to influence them directly or indirectly. Nor does the record contain any evidence to show whether, or the extent if any, to which such decisions might have reflected policies or views of plaintiff's management as a result of general knowledge of such policies or views on the part of Employees Securities' officers or directors. Employees Securities did not hesitate to take advantage of changing conditions, from time to time, by realizing gains on securities through open market sales. Such gains were

not taken into current income on the books of Employees Securities but rather were credited to a reserve against which any losses could be charged. Sizable losses were charged against that reserve during the depression years of the early 1930's.

8. Employees Securities never defaulted on the principal of or interest on any of its outstanding bonds. However, in about April of 1932, its capital became impaired. Plaintiff, though it had no contractual obligation to do so, corrected this impairment by putting $7,500,000 into Employees Securities in exchange for preferr[illegible]tock. In June of 1932, plaintiff contributed secu[illegible] the va[illegible]e of $28,899,000 to the capital of Employees [illegible]rities. This latter contribution was returned to plaintiff in the form of special dividends paid out of capital surplus in 1935 and 1936, when the market value of Employees Securities' other assets had increased sufficiently to provide adequate protection for the bonds. Again in 1939, plaintiff contributed to the capital of Employees Securities, securities of its affiliated corporations of the value of $15,000,000, and also surrendered for cancellation the preferred stock it held. These steps were taken to afford additional protection for the outstanding bonds.

9. The investment position of Employees Securities in plaintiff's common stock remained substantially constant over the years and increased materially in value. As of January 1, 1936, Employees Securities held in its investment portfolio 532,000 shares of plaintiff's common stock. In 1938, it sold 8,600 shares and purchased 5,600 shares of plaintiff's common stock on the open market. No other purchases or sales of plaintiff's stock were made between January 1, 1936, and the complete liquidation of Employees Securities in 1948. The sale of 8,600 shares in 1938 was made to realize gains for income tax purposes which could be offset against deductions for interest paid on the bonds. The repurchase of 5,600 shares in the same year was to restore Employees Securities' position in plaintiff's stock.

10. Beginning in 1942, Employees Securities filed Federal income tax returns as a regulated investment company (§§ 361, 362, 1939 I.R.C., as amended). The practical effect of filing such returns was that if a qualified corporation distributed all of its income, it had no tax liability. This was accomplished by the payment to plaintiff of dividends on Employees Securities' common stock. As sole stockholder, plaintiff, by agreement with the bondholders, was entitled to the same rate of return on its investment as the bondholders received on theirs. During most of the years of its existence, Employees Securities paid dividends to plaintiff in cash. In 1945, 1947, and 1948, however, Employees Securities distributed to plaintiff, as dividends on its common stock, shares of plaintiff's common stock aggregating 53,200 shares. These dividends in kind were made because the directors of Employees Securities knew that plaintiff could use such shares for its own corporate purposes. After payment of these dividends in kind, Employees Securities held 475,800 shares of plaintiff's common stock.

11. In addition to its outstanding bonds, Employees Securities issued notes to the General Electric Additional Pension Trust, a trust to which employees contributed to supplement their pensions. Also, other employee plans to which plaintiff's employees had contributed used Employees Securities as a medium of investment of their funds.

12. By 1948, conditions had changed so that Employees Securities could no longer function as a medium of investment for employee savings. New bonds could not be issued to employees on a basis that would pay an attractive rate of return. As of June 1, 1948, plaintiff and Employees Securities adopted a plan for the complete liquidation of Employees Securities. The plan of liquidation provided for the calling for redemption of Employees Securities' outstanding debenture bonds (held by the participating employees) and notes (held by the General Electric Additional Pension Trust and other employee plans) in the amounts of $30,534,380 and $29,283,000, respectively. As

of that date, Employees Securities held in its investment portfolio 475,800 shares of the common stock of plaintiff which were carried on its books at a cost value of $6,636,557.50.[1] Its total investment portfolio at that date aggregated $107,217,612.51 at cost. The presence of 475,800 shares of plaintiff's stock in Employees Securities' portfolio did not affect the decision to liquidate that corporation. Pursuant to the plan of liquidation, and after provision for complete redemption of the outstanding debenture bonds and notes of Employees Securities, these 475,800 shares of plaintiff's stock, together with other assets held by Employees Securities, were assigned to plaintiff on September 23, 1948. At the time of the liquidation, Employees Securities had funds in excess of amounts due its creditors and plaintiff. A 15 percent bonus was therefore paid to the bondholders and, pursuant to agreement between the bondholders and plaintiff, the balance of the excess funds was paid over to the G. E. Pensioners Hospitalization Trust, a trust for pensioners of plaintiff.

13. Among the other assets assigned to plaintiff by Employees Securities, upon its liquidation, was a portfolio of securities, largely common stocks, of corporations not affiliated with plaintiff. Upon their receipt, plaintiff charged these securities on its books to an account known as Miscellaneous Securities. Thereafter, they were liquidated by plaintiff through open market sales as quickly as was practicable. This was done because of a general policy of plaintiff not to invest its surplus funds in common stocks of corporations not affiliated with it, except for some special purpose. Any difference between the cost of these securities and what was received for them on the market was transferred to earned surplus.

14. From October 13, 1904, and until its complete liquidation in 1947, Electrical Securities Corporation was a New

[1] Plaintiff disposed of these shares at their market value on the dates of disposition, which was between $15,000,000 and $20,000,000.

York corporation. At all times material here, all of its outstanding common stock was owned by plaintiff. It was originally organized and operated for the purpose of extending credit to the public utility industry. After December of 1928, aside from the administration of investments previously made, the primary purpose of Electrical Securities Corporation was to act as a medium of investment of the funds of the General Electric Pension Trust. This pension trust had been established by plaintiff in 1927 to hold funds contributed by plaintiff for the payment of pensions to eligible employees on retirement. In September of 1946, plaintiff modified its pension plan so that thereafter contributions were made both by plaintiff and by participating employees. The trust agreement provided that no employee money could be invested in securities of corporations affiliated with plaintiff. Accordingly, Electrical Securities Corporation could no longer serve as a medium of investment of the funds in the pension trust and it was liquidated in 1947. As of the time of its liquidation in 1947, Electrical Securities Corporation held no shares of plaintiff's common stock.

15. At all times material here, plaintiff owned directly or indirectly the controlling interest in certain affiliated corporations through which it conducted a substantial portion of its business. During the years 1951 and 1952, twelve of these affiliated corporations were merged with, or liquidated into, plaintiff.

16. Plaintiff has been active in establishing benefit plans for its employees for many years. Its original pension plan was started in 1912. In addition to the various employee plans considered in these findings, plaintiff has established a life insurance plan, a hospitalization insurance plan, a product purchase plan, and a pension hospitalization plan. None of these involved the use of plaintiff's own or treasury stock.

17. For many years before the period here involved, plaintiff and certain of its affiliated corporations had paid

"extra compensation" to employees in important and superyisory positions, including executive officers, under a plan called "Extra Compensation Plan." On April 17, 1934, plaintiff's stockholders had authorized the continuation of the plan and empowered the directors "to set aside and disburse in any year out of the earnings of a department or the Company as a whole, as the Plan may be applicable, after deduction of eight per cent (8%) on the average investment in the department or of the Company as a whole, after providing for all charges and reserves, an amount not in excess of eight per cent (8%) of the balance of such earnings." The plan was administered by a committee of the board of directors. Under the rules adopted by the committee, it was provided in part as follows:

> 10. Payments, at the option of the Committee, will be made in cash or securities, or both, as soon as possible after April 1st of the succeeding calendar year. If common stock of the General Electric Company is so distributed, the price of such stock shall be the closing price on the New York Stock Exchange on a date to be decided upon by the Committee.

18. Under date of March 17, 1948, plaintiff sent to its stockholders notice of the annual meeting of stockholders to be held on April 20, 1948. Among other things, the notice proposed an amendment to plaintiff's Extra Compensation Plan. In the proxy statement accompanying the notice of the annual meeting, the following comment on the Extra Compensation Plan was made:

> The Board of Directors of your Company has been deeply concerned for some time with the problem of attracting to and retaining in the service of the Company an able group of executives and of obtaining from this group continuous optimum results from the standpoints of co-operation, interest, ingenuity and efficiency of operation. The problem assumes par-

ticularly important proportions at this time because with the impending completion of the Company's post-war expansion and decentralization programs, it is essential that the Company's top management group be comprised of an able, smooth working and efficient team if maximum profit results are to accrue from these two major programs.

The result sought has been the objective of the Company's long-standing Extra Compensation Plan under which the principal contributors to the success of the Company are made participants in that success.

* * *

The proposed amendment to the plan was approved by the stockholders at the annual meeting on April 20, 1948.

19. The material features of the Extra Compensation Plan as so amended may be summarized as follows:

(a) The board of directors was authorized to set aside and disburse in any year out of the earnings of a department or the plaintiff as a whole, after deducting 8 percent on the average investment, an amount not in excess of 8 percent of the balance of such earnings.

(b) The directors had the right to modify or terminate the plan at any time but no change could be made which would increase the amount appropriated without prior approval of the stockholders.

(c) The plan was to be administered by a committee of the board of directors, appointed by the board from their own number and known as the Salary and Extra Compensation Committee.

(d) The amount to be distributed under the plan was to be published each year in plaintiff's annual report.

20. The Extra Compensation Plan, as amended in 1948, had two parts. In carrying out the first part of the plan,

the Salary and Extra Compensation Committee, as soon as practicable after the first of each year, selected participants from employees in important positions who had shown unusual capacity and value. Distributions to these participants were made as soon as possible after April 1 of each year, but for the previous year. With respect to the great majority of the participants, the Committee had the following discretion:

> (2) Allotments under the Plan to all other participants shall be paid in full as soon as is practicable. Such payments may, in the absolute discretion of the Committee, be made wholly or partly in cash, in General Electric Company common stock, or in other securities. For the purpose of such distribution, General Electric common stock shall be valued at the closing market price on the New York Stock Exchange on the nearest day of sale preceding the date of allotment, and other securities at their fair market value on the day of allotment and such valuation by the Committee shall be conclusive.

The words "other securities" had been included in the rules for the administration of the plan since 1936, and were designed to maintain flexibility in the administration of the plan in case some future management of the company should ever contemplate using securities other than General Electric common stock as a result of a change in the concept of the plan from that which prevailed throughout the period in question here, when no other securities were used.

21. The second part of the Extra Compensation Plan, as amended in 1948, applied only to relatively few of the participants under the plan, estimated to number from 40 to 60. These were in the top management group. Under this feature of the plan, the Salary and Extra Compensation Committee had the discretion to divide any allotment to any of these employees into two approximately equal parts. One

part was used to determine the nearest number of full shares of plaintiff's stock which such part would purchase at the closing market price on the New York Stock Exchange on the nearest day of sale preceding the allotment date. This number of shares was then contingently allotted to the participant and was to be paid to him in 10 to 15 annual installments following the year in which the participant's employment terminated. Each allotment was subject to forfeiture or partial forfeiture by the participant under certain specified conditions. During the period preceding the actual distribution of plaintiff's shares of stock contingently allotted to the participant, no dividends were paid thereon, but amounts equivalent to the dividends which would have been declared on such shares if they had been outstanding were contingently credited to the participants. These credits, called "dividend equivalents," were payable at the time each contingent allotment of shares was distributed to the participant and were subject to the same conditions as were applicable to the shares of plaintiff's stock contingently allotted. The second part of the allotment was to be paid in cash to the participant as soon as was practicable.

22. Effective as of April 17, 1951, the name of the Extra Compensation Plan was changed to Incentive Compensation Plan.[2] As the Incentive Compensation Plan, it remained in effect through 1953 to the present time and was not further amended until May 21, 1954.

23. All distributions under the Extra or Incentive Compensation Plan were made annually on or about April 1. From January 1, 1936, through 1953, the awards (except

---

[2] In an effort to minimize confusion that might occur as a result of this change in the name of the plan, the plan will be referred to as the "Extra or Incentive Compensation Plan" in subsequent findings, where the period of time involved covers both the Extra Compensation Plan and the Incentive Compensation Plan. Otherwise the name currently in effect, as of the time referred to, will be used.

contingent allotments) made to plaintiff's employees (including those in affiliated corporations) after withholding of income tax (after the Current Tax Payment Act of 1943 became effective) were paid approximately one-half in cash and one-half in plaintiff's common stock. If an employee left the payroll of plaintiff before the time of distribution, his award was paid entirely in cash. The Compensation Committee of plaintiff's board of directors in its discretion determined the award to be paid to each participating employee in a specified dollar amount. The market price of the stock had nothing to do with that determination or with fixing the date of distribution. The market price was taken into consideration only in determining the number of shares to be distributed to each employee in satisfaction of the part of his dollar award that was payable in plaintiff's common stock.

24. During the years 1937 through 1946, plaintiff made payment of additional compensation to certain of its sales managers and to others of its employees who had performed outstanding services but who in each case did not participate in distributions made pursuant to plaintiff's Extra Compensation Plan. The manner and amount of such payments were determined by plaintiff's president in his discretion. Such payments are referred to hereinafter as "Additional Compensation." After 1946, payments of Additional Compensation made to certain of plaintiff's sales managers were called "Commissions." Such payments were made in the years 1947 through 1953 and are referred to hereinafter as "Commissions." Shares of plaintiff's common stock were used in the payment of additional Compensation and Commissions. Distributions as Additional Compensation or Commissions were made at the same time of the year as those made under the Extra or Incentive Compensation Plan.

25. During the years 1936 through 1953, plaintiff made the following distributions of shares of its own common

stock under its Extra or Incentive Compensation Plan and as Additional Compensation and Commissions:

Year	Extra/Incentive Compensation	Additional Compensation	Commissions
1936	6,419		
1937	12,757	889	
1938	31,853	2,389	
1939	11,912	27	
1940	16,846	1,647	
1941	38,093	1,407	
1942	57,547	2,987	
1943	26,661	129	
1944	21,935	216	
1945	18,600	74	
1946	18,596	82	
1947	14,157		598
1948	35,249		818
1949	49,227		1,082
1950	40,097		618
1951	51,434		942
1952	43,428		924
1953	42,372		603

The following is representative of the form letter used by plaintiff for the years 1949 through 1953 to notify its participating employees of their awards under the Extra or Incentive Compensation Plan:

Dear Mr. ...

It is a pleasure to inform you that Extra Compensation has been allotted to you for the year 1950 in the amount of $..... which is being paid as indicated below.

May I take this opportunity to thank you for your efforts in our common enterprise.

Payment is made partly in General Electric stock because it seems desirable to encourage leading employees to have a financial stake in the Company to which they are devoting so much of their time and

energy. It should be clearly understood, however, that the stock is your property and may be retained or disposed of according to your own judgment.

Cordially yours,

Method of Paying Extra Compensation

Allotment shown above ..... $
Income tax withheld .....
Certificate for shares of General Electric Common stock at $54.125 per share .....
Check .....

26. In using its treasury stock for distributions under the Extra or Incentive Compensation Plan, rather than cash or the stock of other corporations, plaintiff had two objectives ancillary to its primary objective of paying additional compensation to its employees: first, to provide an incentive for its key employees to put forth their best efforts in behalf of the company; and, second, to obtain for plaintiff a continuing benefit by giving these key employees a continuing stake in the affairs and future financial success of the company. Acting within the scope of the Compensation Committee's discretion under the plan to decide what part of the sum payable to the employee would be in cash and what part would be in stock and to decide whether to use plaintiff's stock or that of some other corporation, plaintiff could have used stock of any other corporation for distributions under the Extra or Incentive Compensation Plan. It never did so and never considered doing so for the reason that by use of stock of another corporation, it would not have accomplished its objective of giving the participants a continuing stake in the affairs and future financial success of plaintiff. In order that the participating employees should have ready marketability for the stock, the ownership of the shares of plaintiff's stock in the hands of the participating employees was not restricted. Since plaintiff's stock was

widely held, control was not a factor under the plan. Plaintiff's management today believes that as a result of years of distributions of plaintiff's stock under the plan, plaintiff has more stockholders among the participating employees than it would have had if the distributions had been all in cash.

27. Effective October 1, 1948, plaintiff, with the approval of its stockholders, established the G. E. Employees Savings and Stock Bonus Plan (hereinafter called the "Stock Bonus Plan"). In recommending the adoption of this plan to plaintiff's stockholders, the management stated in part as follows:

> The management of the Company believes it highly desirable to work out at this time another long range program for employee savings. In view of the success and popularity of such plans in the past and the very great assistance which they have afforded participating employees in time of economic stress, the management believes that the cost of such a plan would be much more than justified by the resulting improvement in employee security and morale. * * *
>
> * * * * * *
>
> * * * Moreover, the management of the Company believes that it would be very much in the interest of both the employees and the Company to have the benefits of any new plan depend at least in part upon the success of the Company.

28. The Stock Bonus Plan, as finally adopted, in substance provided as follows:

> (a) All employees including those of affiliated companies, except directors, senior officers and some major executives, could elect to participate in the plan.
>
> (b) To participate, an employee would authorize regular payroll deductions within certain specified limits

for the purchase of U.S. Savings Bonds, Series E, and deposit with the plaintiff the bonds so purchased.

(c) The employee would authorize plaintiff to retain the bonds so purchased in custody for his account for approximately a five-year holding period. The authorization was revocable, and an employee was entitled to withdraw his bonds in the custody of the company at any time.

(d) At the end of such holding period, the bonds were to be delivered to the owner thereof.

(e) Concurrently with the delivery of the bonds to the owner at the end of the holding period, the plaintiff agreed to have delivered to the employee a stock bonus and the income accumulated thereon. The bonus consisted of shares of plaintiff's common stock equal to 15 percent of the aggregate cost of the savings bonds purchased by the employee for each year and in the custody of plaintiff at the end of the year.

(f) In the event any employee should withdraw his bonds from the custody of plaintiff prior to the expiration of the holding period, he would forfeit his right to the stock bonus but not his right to any income accumulated with respect to the forfeited stock bonus.

29. Under date of April 22, 1949, plaintiff established the G. E. Employees Stock Bonus Trust (hereinafter called the "Stock Bonus Trust") to implement the Stock Bonus Plan. The Stock Bonus Trust was to receive and hold the shares of plaintiff's common stock constituting the stock bonus under the Stock Bonus Plan, to collect and invest the dividends received on the stock held in the Stock Bonus Trust, and to deliver the shares of plaintiff's stock and the income accumulated thereon to the person or persons entitled thereto. The dividends received by the Stock Bonus Trust were usually invested in short-term Government securities.

No investments in stocks of other corporations were made. Under date of August 25, 1949, the Internal Revenue Service ruled that "the plan [Stock Bonus Plan] will meet the requirements of section 165(a) of the Internal Revenue Code, as amended, and that the trust [Stock Bonus Trust] established thereunder, will be entitled to exemption under the provisions of that section." Said ruling further held that—

> Contributions made to the trust will be allowable as deductions from gross income in accordance with Section 23(p) of the Internal Revenue Code, as amended, subject, however, to verification upon examination of your return.

One of plaintiff's reasons for using its stock under the Stock Bonus Plan and Trust was to meet the qualification requirements of section 165(a) of the Internal Revenue Code of 1939. During the period involved here, the trustees of the Stock Bonus Trust, who were officers of plaintiff, and who had power under the terms of the trust to vote the shares of plaintiff's stock held in the trust, did not vote such shares.

30. Plaintiff's purpose in establishing the Stock Bonus Plan for its employees was to afford them a convenient means of purchasing U.S. Savings Bonds, Series E, to encourage them to retain the bonds, to provide the participating employees a higher rate of return, and to give them a financial interest in plaintiff through ownership of its stock. Contributions of its stock to the Stock Bonus Trust were made by plaintiff in February of each year. No stock of any other corporation has ever been used, and the Stock Bonus Plan is still in effect.

31. During the years 1949 through 1953, plaintiff made the following transfers of shares of its common stock held in its treasury to the Stock Bonus Trust as contributions under plaintiff's Stock Bonus Plan:

Year of Transfer	*Shares Transferred*
1949	19,537.67
1950	78,537.09
1951	46,944.54
1952	39,485.76
1953	43,142.35

32. During the years 1949 through 1953, plaintiff sold, at the market price, the following shares of its common stock held in its treasury to certain of its affiliated corporations for use by said corporations as transfers to their employees under the Extra Compensation Plan or Incentive Compensation Plan and as transfers to the Stock Bonus Trust as contributions under plaintiff's Stock Bonus Plan:

Year of Sale	*Shares Sold*
1949	9,864.33
1950	10,256.91
1951	10,901.46
1952	7,867.24
1953	2,865.65

The types of employees of the affiliated corporations who were eligible to participate in said plans were the same as the types of plaintiff's employees who were eligible to participate therein. In each instance, plaintiff sold to the affiliated corporation the number of shares which the latter then needed under one of the plans. The affiliated corporations did not ever buy plaintiff's stock on the open market for use under said plans. Plaintiff's treasurer's office was responsible for the acquisition of plaintiff's stock on the open market for use by both the plaintiff and the affiliated corporations under the plans, both because the staff of that office had the contacts and experience required to perform that work adequately and efficiently, and because, if the affiliated corporations had purchased shares on the open market themselves in anticipation of their requirements, they might have acquired more shares or fewer shares than

were actually needed. All such sales of treasury stock by plaintiff to its affiliated corporations were made at the market prices of plaintiff's common stock prevailing on the New York Stock Exchange. From 1936 through 1948, plaintiff also sold shares of its own stock to affiliated corporations for use in the payment of Extra Compensation. All such sales of treasury stock were made at the market prices prevailing on the New York Stock Exchange. The affiliated corporations never used the stock of any other corporation for these purposes.

33. As of October 31, 1945, pursuant to a plan of reorganization under section 112(g)(1) of the Internal Revenue Code of 1939 with Electric Vacuum Cleaner Company, Inc., a New York corporation, plaintiff acquired all of the assets of the latter corporation in exchange for 65,918 shares of plaintiff's common stock then held in its treasury. Electric Vacuum Cleaner Company, Inc., was a manufacturer of vacuum cleaners which plaintiff sold and distributed. Plaintiff wished to manufacture the cleaners itself. Accordingly, it entered into negotiations to take over the assets of the vacuum cleaner company. Plaintiff was informed that the stockholders of Electric Vacuum Cleaner Company, Inc., would not consent to the exchange unless the transaction was a tax-free reorganization to them under the provisions of the Internal Revenue Code of 1939.

34. As of November 1, 1946, pursuant to an agreement and plan of reorganization dated October 18, 1946, plaintiff acquired 4,000 shares of common stock and 1,567 shares of preferred stock, being all of the outstanding common stock and 96.5 percent of the outstanding preferred stock of The Mahoning Valley Steel Company, an Ohio corporation. The sole consideration transferred by plaintiff to the former owners of The Mahoning Valley Steel Company in exchange therefor was 52,896 shares of plaintiff's common stock then held in its treasury. Plaintiff's officials were informed that the stockholders of the Mahoning Valley Steel Company would not consider disposing of their stock except on the basis of a tax-free merger or reorganization.

35. Plaintiff's Advisory Committee was a standing committee, composed of certain of plaintiff's top executive officers, which advised the president of plaintiff in regard to major matters of general company policy and operations. In February and March of 1953, the Advisory Committee considered and recommended that effective April 1, 1953, payments to employees of plaintiff, who filed patent applications, be made on the following basis:

(a) To employees in the research laboratory—$25.00 in cash.

(b) To all other employees, one share of plaintiff's stock plus enough cash to offset the withholding tax.

Pursuant to the recommendations of the Advisory Committee, plaintiff in 1953 transferred 508 shares of its common stock held in its treasury to employees of plaintiff who had filed patent applications covering inventions made by them. For some years before 1953, plaintiff had made awards, called the Charles A. Coffin Memorial Awards, to certain of its employees for outstanding accomplishments. Charles A. Coffin was the founder and creator of plaintiff. In 1953, plaintiff made Coffin awards to 40 of its employees consisting of five shares of plaintiff's common stock held in its treasury to each recipient or a total of 200 shares. Plaintiff's management considered these transfers of plaintiff's stock as honorariums, hoping they might give the recipients a feeling of participation in the affairs of the company even though on a very small basis.

36. To publicize the celebration of plaintiff's seventy-fifth anniversary on October 15, 1953, plaintiff on January 15, 1953, made the following announcement:

BABY DERBY TO HELP MARK G.E.'s 75TH ANNIVERSARY

NEW YORK, N.Y., Jan. 14—Seventy-five years ago on October 15, thirteen confident investors organized a company for the purpose of inventing an electric lamp.

This was the Edison Electric Light Company, the first of the firms which, in 1892 became the General Electric Company.

To salute the occasion, General Electric today announced that it is preparing to create another group of share owners on the anniversary date by awarding five shares of company stock to babies born to G-E employees on October 15.

General Electric now has approximately 210,000 employees. To be eligible for the baby derby, at least one parent must be on the company payroll as of today and the October 15 stock "date of issue."

With something less than their normal confidence, G-E statisticians estimated that the new group might be composed of the same number of new share owners as the original group.

On October 15, 1953, 191 children were born to employees of plaintiff and its affiliated corporations. Pursuant to the foregoing announcement, plaintiff issued in trust for each of such children five shares of its common stock held in its treasury. Of these shar s, 950 were issued in 1953 and the equivalent of five in 19 4 (fifteen after an intervening 3 for 1 stock split in 1954). The baby derby was inaugurated and carried out for its publicity value to plaintiff. No stock of another corporation has ever been used by plaintiff for any similar purpose.

37. On November 24, 1953, plaintiff sent a letter to Canadian General Electric Company, Limited, a Canadian corporation, offering to acquire, at $550 per share, the minority outstanding shares of stock of that corporation. The average price of Canadian General Electric stock during 1953 was $438. Plaintiff then owned approximately 96 percent of it. The remaining stock was in the hands of Canadian stockholders and owners resident in Great Britain, on the Continent and in the United States. Stockholders in

Canada, Great Britain and on the Continent were given the choice of receiving payment either in cash or in plaintiff's common stock. This offer to pay in plaintiff's stock was made with the hope that the alternative of participation in the over-all enterprise would operate as an inducement to the minority stockholders to accept the offer. No such right of receiving plaintiff's stock was extended to minority stockholders in the United States because that would have necessitated the expense of registering plaintiff's stock under the Securities and Exchange Act of 1934. During the remainder of 1953, pursuant to the foregoing offer, plaintiff transferred to former owners of stock of Canadian General Electric Company, Limited, 7,747 shares of plaintiff's common stock then held in its treasury.

38. Plaintiff's annual meeting of its stockholders for 1953 was held on April 21, 1953. At that meeting, Dr. Benjamin P. Whitaker acted as Chairman of the Inspectors of Election. In May of 1953, plaintiff issued to Dr. Whitaker two shares of its common stock held in its treasury in connection with his services as Chairman of the Inspectors of Election.

39. During the years 1949 through 1953, plaintiff made no further dispositions or sales of its common stock held in its treasury except as follows:

Year	*Transferee*	*No. of Shares*	*Purpose*
1950	Harvard University	6,700	Charitable Contribution
1952	General Electric Educational and Charitable Fund.	100	Do.
	American Institute of Electrical Engineers.	150	Do.
1953	St. Vincent's Hospital Association, Erie, Pa.	2,150	Do.
	General Electric Educational and Charitable Fund.	44,900	Do.

40. The record contains no evidence that plaintiff has ever sold shares of its treasury stock on the open market.

41. As of January 1, 1936, plaintiff held 7.56 shares of its own common stock in its treasury. The following schedule sets forth the acquisitions by plaintiff of its common stock from January 1, 1936, to January 1, 1949:

Year	*No. of Shares Acquired*	*Source*
1936	2.48	Purchased on open market
	8,111	Purchased from Electrical Securities Corporation
	96,000	Dividend from Electrical Securities Corporation
1937	1.24	Purchased on open market
1938	18,939	Purchased from Electrical Securities Corporation
1939	6,134	Do.
1940	.24	Purchased on open market
	2,331	Purchased from Electrical Securities Corporation
1941	25,000.52	Purchased on open market
	61,400	Purchased from Electrical Securities Corporation
1942	42,400	Purchased on open market
1943	35,200.32	Do.
1944	47,400	Do.
1945	36,600	Purchase on open market
	12,300	Dividend from Electrical Securities Corporation
	6,800	Dividend from G.E. Employees Securities Corporation
1946	65,500	Purchased on open market
	8,350	Dividend from Electrical Securities Corporation
1947	20	Purchased on open market
	36,400	Dividend from G.E. Employees Securities Corporation
1948	16,700	Purchased on open market
	10,000	Dividend from G.E. Employees Securities Corporation
	475,800	Distribution upon liquidation of G.E. Employees Securities Corporation

The stock so acquired was not retired but was held by plaintiff as treasury stock.

42. During the period from January 1, 1936, to December 31, 1953, plaintiff maintained a record by certificate numbers of its acquisitions and dispositions of its common stock. As of January 1, 1949, plaintiff held in its treasury 497,778.36 shares of its common stock. These specific shares had been acquired in the following manner:

	Shares
Purchased on the open market	9,700.36
Dividends received in 1947 and 1948 from G.E. Employees Securities Corporation	12,278.00
Distribution in 1948 upon liquidation of G.E. Employees Securities Corporation	475,800.00
Total	497,778.36

The 9,700.36 shares held by plaintiff as of January 1, 1949, which had been purchased on the open market, had been acquired pursuant to authorizations by plaintiff's board of directors for use in payment of Extra Compensation and for other corporate purposes.

43. The following schedule sets forth the acquisitions by plaintiff of its common stock from January 1, 1949, to December 31, 1953:

Year Acquired	*Source*	*No. of Shares*
1949	.....	0
1950	Purchased on open market	.56
	Purchased from G.E. Employees Stock Bonus Trust pursuant to Article IV, 3(b)	117
	Total	117.56
1951	Purchased on open market	42,746.72
	Purchased from G.E. Employees Stock Bonus Trust pursuant to Article IV, 3(b)	129
	Distribution upon merger or liquidation of:	
	Carboloy Company, Inc.	316
	General Electric X-ray Corporation	85
	Locke Incorporated	467
	Monowatt Incorporated	201
	Telechron Inc.	880
	The Trumbull Electric Manufacturing Company	435
	Total	45,259.72
1952	Purchased on open market	143,700
	Purchased from G.E. Employees Stock Bonus Trust pursuant to Article IV, 3(b)	138
	Distribution upon merger or liquidation of:	
	Hotpoint, Inc.	2,186
	International General Electric Company, Inc.	1,555
	Total	147,579
1953	Purchased on open market	146,500
	Purchased from G.E. Employees Stock Bonus Trust pursuant to Article IV, 3(b)	161
	Total	146,661

The stock so acquired was not retired but was held by plaintiff as treasury stock.

44. All of the open market purchases in 1951, 1952, and 1953 were made pursuant to authorizations by plaintiff's board of directors for use in payment of Extra or Incentive Compensation, distributions under the Stock Bonus Plan, or other corporate purposes.

In the opinion of the officials of the plaintiff responsible for seeing to it that an adequate supply of stock was on hand to meet those purposes, the shares on hand in 1949 and 1950, as a result of the liquidation of G. E. Employees Securities Corporation in 1948, were sufficient for those purposes. Accordingly, no open market purchases were made in 1949 and 1950 (except for a fractional share redeemed). During 1951, these officials reached the conclusion that by 1952 plaintiff might not have on hand a sufficient number of shares of its own stock to take care of distributions under the Incentive Compensation and Stock Bonus Plans to be made in the spring of 1952. About mid-year in 1951, plaintiff's Office of Banking and Corporate Finance Service recommended that 100,000 additional shares be purchased in 1951, and, after authorization by the board of directors to purchase up to 100,000 shares, plaintiff began to purchase shares on the New York Stock Exchange through regular brokers. The purchases in 1951, 1952, and 1953 were made for corporate purposes and were made in fixed amounts over extended periods of time so as to minimize any effect they might have on the market. The brokers used to acquire these shares were instructed to buy a fixed amount of shares each trading day. The price or prices at which the brokers bought were left to their discretion. Plaintiff expected the brokers to average the market prices in these purchases. The open market purchases during these years were geared to plaintiff's estimated needs for its stock. It has been plaintiff's practice not to make private purchases of large blocks of its own

stock. It has been plaintiff's policy not to use newly issued stock except in very exceptional cases. None was used during the years 1936 through 1953.

45. The purchases by plaintiff in 1950, 1951, 1952, and 1953 of small amounts of its own stock from the Stock Bonus Trust were pursuant to authority granted in the trust to the trustees to sell such of plaintiff's stock as might be necessary to provide funds for payment for fractional interests in plaintiff's stock. The shares of its own stock acquired by plaintiff in 1951 and 1952, upon the merger or liquidation of certain of its affiliated corporations, represented shares held by such corporations on account of contingent allotments previously made to their employees under the deferred feature of the Extra or Incentive Compensation Plan.

46. At the end of 1953, plaintiff held 273,000 shares of its own stock in its treasury. Of these, 78,000 shares had already been set aside under the deferred feature of the Extra or Incentive Compensation Plan and hence were not available for use again. Plaintiff considered the balance of 195,000 shares adequate in view of its requirements for 1953 and its estimated requirements for 1954.

47. At all times between January 1, 1936, and December 31, 1953, plaintiff recorded acquisitions of treasury stock on its books of account by a charge to an asset account entitled "G.E. common stock reacquired." This was a separate account on plaintiff's ledgers, the use of which was confined solely to recording the acquisitions of plaintiff's common stock. In the balance sheets included in plaintiff's reports to its stockholders and in those attached to plaintiff's income tax returns, such stock was likewise carried as an asset, separately reported under the heading of investments. It was the practice of plaintiff during the years here involved to make an explanatory note as to the purposes for which its stock was held. The note accompany-

ing the balance sheet in plaintiff's report to its stockholders for 1952 is typical and reads as follows:

> Note 9. General Electric common stock in the portfolio was held for corporate purposes and was carried at its cost. There were 159,335 shares held on December 31, 1952, the aggregate quoted market value of which was $11,591,595.

Plaintiff's officials responsible for this accounting procedure believed that, since plaintiff had acquired shares of its own stock with no intention of retiring them, but for specific corporate purposes, it was more informative to its stockholders to carry the stock on the asset side of its balance sheets. They also believed that whether plaintiff's treasury stock was carried on the asset or liability side of its balance sheets was of relatively little significance. Plaintiff's public accountants never differed with plaintiff's practice. This stock could have been placed on the liability side of the balance sheet and shown as a reduction of capital. If that had been done, an explanatory note would have been necessary, indicating that plaintiff intended to use the stock for corporate purposes.

48. Upon the disposition of treasury stock, any difference between its fair market value and its cost was recorded by plaintiff on its books of account in its capital surplus account and no income therefrom was reported in its financial statements. The ultimate result would have been the same had plaintiff carried its treasury stock on the liability side of its balance sheets, according to an alternative accounting practice preferred by some authorities. In either case, any difference between what was paid for the stock and the value received upon its disposition would be reflected in capital surplus and would not appear as income. With respect to the dispositions of treasury stock under the Extra or Incentive Compensation Plan, to the Stock Bonus Trust,

as patent awards in 1953, as Coffin awards in 1953, under the baby derby in 1953, to the Inspectors of Election in 1953, and as charitable contributions, the net result of the entries recorded on plaintiff's books of account was a charge to expense accounts for the fair market value of the stock, a credit to the G. E. common stock reacquired account for the cost of the stock, and a charge or credit to the capital surplus account for any difference between the fair market value of the stock and its cost.

49. With respect to the treasury stock sold by plaintiff during the years 1949 through 1953 to certain of its affiliated corporations for use under the Extra or Incentive Compensation Plan and as transfers to the Stock Bonus Trust, the net result of the entries recorded on plaintiff's books of account was a charge to receivable accounts for the fair market value of the stock sold, a credit to the G. E. common stock reacquired account for the cost of the stock, and a charge or credit to the capital surplus account for any difference between the fair market value of the stock and its cost. With respect to the disposition in 1953 of plaintiff's treasury stock in the acquisition of minority shares of stock of Canadian General Electric Company, Limited, the net result of the entries recorded on plaintiff's books of account was a charge to investment in affiliated companies account for the fair market value of the stock, a credit to the G.E. common stock reacquired account for the cost of the stock, and a credit to the capital surplus account for the difference between the fair market value of the stock and its cost. None of plaintiff's common stock held by it in its treasury carried voting rights and no dividends were paid thereon.

50. The high and low market prices of plaintiff's common stock as traded on the New York Stock Exchange for the years 1936 to 1953 are as follows:

Year	High	Low
1936	$55	$34.50
1937	64.875	34
1938	48	27.25
1939	44.625	31
1940	41	26.125
1941	35.125	24.75
1942	30.75	21.5
1943	39.875	30.75
1944	40.375	35
1945	49.625	37.875
1946	52	33.5
1947	39.875	32
1948	43	31.75
1949	42.375	34
1950	50.5	41.125
1951	63.875	49.5
1952	72.75	54.375
1953	92.25	66.25

51. For each of the years 1936 through 1952 on its Federal income tax returns, plaintiff reported as capital gains or losses the differences between the tax cost basis of the shares of its common stock held in its treasury and disposed of in such year and the market value thereof. On its 1953 return, plaintiff did not report any capital gains or losses based on such differences in respect of treasury stock disposed of in that year because plaintiff's officials responsible for the accounting treatment of such differences for tax purposes had reached the conclusion that such differences did not constitute capital gains or losses. Such differences were, however, treated as capital gains and losses by the District Director upon examination of plaintiff's 1953 return, and resulted in assessment and payment of additional tax.

No capital gain or loss was reported with respect to the shares disposed of in 1950, 1952, and 1953 as charitable contributions.

52. For the years 1949 through 1953 on its Federal income tax returns or, in the case of its 1953 return, as the result of examination thereof, plaintiff reported and paid a tax thereon on the following net capital gains with respect to the shares of its common stock held in its treasury and disposed of as set forth in these findings, with the exception of the charitable contributions in 1950, 1952, and 1953:

Year	*No. of Shares*	*Net Capital Gain*
1949	79,711.00	$1,109,628.31
1950	129,509.00	3,777,069.17
1951	110,222.00	4,960,782.61
1952	91,705.00	873.295.94
1953	98,390.00	544,232.81

Three factors in combination contributed materially to the size of these gains: (1) the large block of plaintiff's common stock it received in 1948 upon liquidation of G. E. Employees Securities Corporation was held by plaintiff at its relatively low cost to G. E. Employees Securities Corporation, because of the tax-free character of that liquidation; (2) it took plaintiff a long time to use up those shares under the various employee plans; and (3) during the period here involved (1949-1953) the market price of plaintiff's stock was in general advancing.

On the basis of the whole record, it is evident that the timing of plaintiff's acquisitions and dispositions of its own stock, in carrying out the various employee plans and other corporate operations described in these findings, was related to fulfillment of the requirements and objectives of such plans and other corporate operations.

53. The following table sets forth for the years 1949 through 1953 the average number of plaintiff's employees, the number thereof who participated in plaintiff's Extra or Incentive Compensation Plan and the number who participated in plaintiff's Stock Bonus Plan:

1949

Number of employees	161,733
Number of participants (E.C./I.C. Plan)	2,257
Number of participants (Stock Bonus Plan)	61,357

1950

Number of employees	165,345
Number of participants (E.C./I.C. Plan)	2,364
Number of participants (Stock Bonus Plan)	61,122

1951

Number of employees	201,543
Number of participants (E.C./I.C. Plan)	2,357
Number of participants (Stock Bonus Plan)	78,718

1952

Number of employees	215,392
Number of participants (E.C./I.C. Plan)	2,417
Number of participants (Stock Bonus Plan)	73,991

1953

Number of employees	231,334
Number of participants (E.C./I.C. Plan)	2,222
Number of participants (Stock Bonus Plan)	90,669

54. With respect to the dispositions made by plaintiff during the years 1949-1953 of its common stock held in its treasury under the Extra or Incentive Compensation Plan and to the Stock Bonus Trust, and in 1953 as patent and Coffin awards, under the baby derby, and to the Chairman of the Inspectors of Election, and in 1950, 1952, and 1953 as charitable contributions, plaintiff on its tax returns claimed and was allowed deductions from gross income under section 23 of the Internal Revenue Code of 1939, as amended, computed upon the fair market value of the stock disposed of. With respect to the dispositions under the Extra or Incentive Compensation Plan and to the Stock Bonus Trust, each deduction was claimed and allowed on the accrual basis

for the taxable year preceding the year in which the corresponding disposition occurred, except that plaintiff claimed and was allowed a deduction for the taxable year 1949 on account of the 19,537.67 shares it transferred in that year to the Stock Bonus Trust.

55. With respect to the sales made by plaintiff of its common stock held in its treasury to certain of its affiliated corporations for use by such corporations under the Extra or Incentive Compensation Plan and as transfers to the Stock Bonus Trust, and with respect to the exchange of such stock for certain minority shares of stock of Canadian General Electric Company, Limited, plaintiff on its tax returns claimed and was allowed no deductions therefor.

56. Within the times prescribed by law, plaintiff filed with the District Director its claims for refund covering the issues raised in its petition. On January 12, 1959, the claims for the years 1949, 1950, and 1951 were disallowed by the Commissioner in accordance with the provisions of section 3772(a)(2) of the Internal Revenue Code of 1939, as amended. On March 6, 1959, the claims for 1952 and 1953 were likewise disallowed by the Commissioner.

57. Plaintiff is the owner of the claims herein asserted and no assignment or transfer of the same or any part thereof has heretofore been made.

Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover and, therefore, its petition is dismissed.

IN THE UNITED STATES COURT OF CLAIMS

No. 299-58

(Decided October 3, 1962)

PENN-TEXAS CORPORATION
(FORMERLY COLT'S MANUFACTURING COMPANY)

v.

THE UNITED STATES

George D. Webster for the plaintiff. *Jules Levinson* and *Davies, Richberg, Tydings, Landa & Duff*, were on the briefs.

John F. Palmer, with whom was *Assistant Attorney General Louis F. Oberdorfer*, for the defendant. *Edward S. Smith, Lyle M. Turner* and *Philip R. Miller* were on the brief.

Opinion

DAVIS, *Judge*, delivered the opinion of the court:

The Penn-Texas Corporation (formerly Colt's Manufacturing Company) sues for a refund of portions of the income taxes it was required to pay for 1951. There are two separate but related issues, both involving treasury stock acquired by the company prior to the taxable year. The first is whether the taxpayer realized taxable gain, in 1951, in exchanging 8,927 shares of the treasury stock at their appreciated value for property transferred to it. The second is whether in the computation of the taxpayer's excess profits tax credit for 1951, under the invested capital method, its treasury stock was includable in its total assets under Section 437 of the Internal Revenue Code of 1939 and as inadmissible assets under Section 440 of the 1939 Code. The latter issue, with respect to the following year (1952), has recently been presented to and

decided by the Court of Appeals for the Second Circuit in favor of the company. *Colt's Manufacturing Co.* v. *Commissioner*, C.A. 2, No. 27250, decided August 20, 1962 (reversing the Tax Court, 35 T.C. 78 (1960)). The Second Circuit's opinion, which bears directly on the second issue before us, is also pertinent to the resolution of the first question.

Colt's,[1] the well-known arms-manufacturing concern, was a Connecticut corporation brought into being in 1855. In 1923 the General Assembly amended the charter to permit the company to purchase and hold a limited number of shares of its own stock "for the purpose of resale from time to time to employees." This power was broadened in 1947 to allow the sale or disposition of acquired treasury stock "at such times and to such persons, firms or corporations and in such manner as to the said board of directors may seem advisable." Under this authorization, Colt's reacquired, prior to December 31, 1949, 4,100 shares of its own stock in the open market, at a cost of $109,394. The purpose of this initial stock-purchase program was to resell the shares to the company's existing employees, as well as for possible distribution under stock options to new executives whom it hoped to enlist; but in fact the shares were never so used.

Another project for the purchase of treasury shares developed out of the company's extraordinary growth during World War II as a result of the increased arms purchases by the Federal Government. After the end of the heavy wartime sales in 1946, Colt's sought employment for its greatly expanded capital in other fields, but found no acceptable venture. Some stockholders, beginning in 1948, voiced dissatisfaction with the large amount of

[1] We shall refer to the taxpayer as Colt's, the name it bore during the period involved in this suit. Penn-Texas acquired Colt's in 1955, and in January 1956 a certificate of dissolution was filed for Colt's with Connecticut's Secretary of State.

unused capital and solicited proxies for the election of independent directors who would be pledged to bring about a substantial distribution of superfluous assets; at the annual meeting in April 1949, three such dissidents were chosen for the eleven-man board. At the same time, the company's directors and officers were considering the possibility of making a distribution to stockholders which would not be taxable to them as ordinary income.

To attain the parallel ends of making such a distribution and also of buying out the minority directors, the board adopted the plan (in February 1950) of purchasing shares from stockholders at prices some $5 to $6 above the then market level (up to a total amount of $7,000,000), and of holding these reacquired shares until disposition "in such manner and upon such terms as the Directors may deem advisable." The stockholders confirmed this plan in March 1950; and by May of that year 124,827 shares had been purchased (at a cost of $6,543,780). The dissident stockholders were bought out and the minority directors ended all participation in the management of the company.

The total of 128,927 treasury shares thereafter possessed by Colt's remained dormant; the company had no specific plans for their use. They were not treated as an asset on the books but were classified as treasury stock and deducted from the issued stock in published financial reports. The company did not vote them, pay dividends on them, or use them as collateral for any loans. During this period, the treasury shares were not retired; that portion of the 200,000 issued shares which remained outstanding was regularly traded on the New York Curb Exchange (the American Stock Exchange); the company was authorized to issue 200,000 additional shares.

In May 1951, Colt's began negotiations with Walter P. Jacob Industries, Inc. for the acquisition of the latter's business and assets, including certain patents, license agreements, and equipment related to the manufacture of

box-making machinery. The arrangement was consummated on July 18, 1951, and included the exchange of 8,927 shares of Colt's treasury stock for $564,632.75 worth of patents and license agreements belonging to Jacob (equivalent to $63.25 per share). Walter P. Jacob became the taxpayer's Executive Vice President.

The Jacob transaction left Colt's with 120,000 treasury shares. These were formally retired by a resolution of the board in December 1952, and a certificate of retirement filed with the Connecticut Secretary of State in January 1953.

The first question we have to answer arises because the Commissioner of Internal Revenue determined that Colt's made a long-term capital gain of $90,277.73 when it transferred the 8,927 treasury shares to the Jacob company in exchange for the acquisition of patent and license rights. The taxpayer insists that, in the circumstances shown by the record, the issuance of this treasury stock was not a taxable transaction under the Internal Revenue Code of 1939 and Regulations.

As the court recently pointed out in *General Electric Company* v. *United States*, No. 145-59, Ct. Cl., decided March 7, 1962, 299 F. 2d 942, the starting point for cases of this type governed by the 1939 Code[2] must be Section 29.22(a)-15 of Treasury Regulation 111 which basically provides that acquisition or disposition by a corporation of its own shares does not give rise to taxable gain or deductible loss unless the "corporation deals in its own shares as it might in the shares of another corporation," and that this standard must be applied to "the real nature of the transaction, which is to be ascertained from all the

[2] This problem does not arise under the 1954 Code, Section 1032 of which excludes from gross income any gain or loss in an exchange of treasury stock for money or other property.

facts and circumstances."[3] This Regulation has been upheld, explicitly or impliedly, by the Supreme Court, five circuits, the Tax Court, and this court. See *General Electric Co.* v. *United States*, *supra*, slip op. at 7-8, 299 F. 2d at 946. But the generality of its phrasing has inevitably led to difficulties in individual cases and the courts have found that they cannot avoid grappling directly with the particular circumstances before them.

The difficulties are compounded by the courts' rejection of all rules-of-thumb for characterizing treasury stock transactions as taxable or not. Failure to retire the shares does not require a result favoring the Commissioner of Internal Revenue (*United States* v. *Anderson, Clayton*

---

[3] The pertinent text of the Regulation is as follows:

"Acquisition or disposition by a corporation of its own capital stock.

Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code."

The history of the Regulation is detailed in *General Electric*, *supra*, slip op., at 6-7, 299 F. 2d at 945-46, as well as in *Anderson, Clayton & Co.* v. *United States*, 129 Ct. Cl. 295, 300-03, 122 F. Supp. 837, 840-42 (1954), *aff'd*, 350 U.S. 55 (1955).

& Co., 350 U.S. 55, 60 (1955), affirming 129 Ct. Cl. 295 (1954)[4]). On the other hand, the fact that the disputed transaction is single, unique, or nonrecurrent is not necessarily decisive for the taxpayer (*Edwin L. Wiegand Co.* v. *United States*, 104 Ct. Cl. 111, 60 F. Supp. 464 (1945)). Nor is speculative trading a prerequisite to taxability (*Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145, 148 (C.A. 2, 1942), *cert. denied*, 317 U.S. 681). It is likewise not controlling, one way or the other, that the shares have no voting rights; that no dividends are paid on them; that the stock is or is not carried as an "asset" on the company's books; or that the taxpayer might conceivably have used authorized but unissued shares, instead of treasury stock, to reach the same objectives (*Hercules Powder Co.* v. *United States*, Nos. 135-57, 152-58 and 318-58, Ct. Cl., decided Feb. 3, 1960, 180 F. Supp. 363; *General Electric Co.* v. *United States*, *supra*, No. 145-59, Ct. Cl., decided March 7, 1962, 299 F. 2d 942). Similarly, it is not enough to assure taxability that, if the company had desired, cash could have been substituted for the stock, with the same general end-result; that would almost always be true and therefore cannot serve as the cardinal touchstone. None of these elements is conclusive in itself, but all may be important, together with other factors, in swinging the balance.

We are thus left to weigh all the "facts and circumstances" of Colt's exchange with Jacob on a scale calibrated only with this very general guide: Has the company "deal[t] in its own shares as it might in the shares of another corporation" (Treas. Reg. 111, § 29.22(a)-15)? Or, to put it another way, has it employed the treasury stock "as an ordinary asset as the stock of another corporation [or cash] would be" (*Commissioner* v. *Air Reduction Co.*,

---

[4] Rejecting such cases as *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, 171 F. 2d 474, 476 (C.A. 2, 1948), and *Commissioner* v. *Landers Corp.*, 210 F. 2d 188, 191-92 (C.A. 6, 1954).

supra, 130 F. 2d at 148; see also *Anderson, Clayton & Co.* v. *United States*, 129 Ct. Cl. 295, 304-05, 122 F. Supp. 837, 843 (1954), *aff'd*, 350 U.S. 55 (1955)). Using that measure as best we can, we agree with the plaintiff that the transaction did not give rise to taxable gain. Colt's did not acquire its treasury stock as an ordinary asset or for investment and it did not hold or use the shares for those purposes; the exchange with Jacob was an adventitious use of treasury stock instead of unissued shares, on a particular occasion, to give the Jacob interests, which were then joining Colt's, a substantial stake in the company.

Of the taxpayer's treasury shares, 4,100 were purchased (in 1949) for the twin objectives of sale to Colt's employees and of possible distribution to new executives who might subsequently become affiliated with the company. In other circumstances such purposes could form an integral part of a company's plan to use treasury shares in discharge of its obligations, in place of cash, other stock, or other property (see *General Electric Co.* v. *United States*, *supra*). But in this case the company, unlike General Electric, had no such continuing program. The possibility of a sale of the shares was still inchoate and potential. Colt's was under no obligation to make stock available to its employees, existing or future, and in fact the 4,100 shares were never so used. There was thus no aim to use treasury shares to fulfill regular obligations to employees—as cash or other assets might be used—but rather the desire to accumulate stock for the "wholly intracorporate purpose" of possibly distributing stock in the future among key members of the organization, should that be thought desirable. See *United States* v. *Anderson, Clayton & Co.*, *supra*, 350 U.S. at 59, 60.[5]

---

[5] *Commissioner* v. *Air Reduction Co.*, *supra*, 130 F. 2d at 146, 148 (C.A. 2), held sales of treasury stock to corporate officers to be taxable, but there the sales were apparently made under an existing plan and pursuant to options previously granted. The company was therefore under a real obligation which it discharged

In purchasing the remaining 124,827 shares of treasury stock in 1950, the company intended (a) to give its stockholders who wished to realize their share of the increased corporate assets the chance to receive their money free from ordinary income tax, and also (b) to eliminate stockholders and directors antagonistic to the management and to the majority of the board of directors. These two purposes are, of course, poles removed from treating the treasury shares as if they were stock in another company, or as an ordinary asset. For these aims, Colt's own shares were peculiarly required and peculiarly fitted. See *Anderson, Clayton & Co. v. United States*, *supra*, 129 Ct. Cl. at 302-03, 122 F. Supp. at 842. And the fact that Colt's reacquired over 60 percent of its issued and outstanding capital stock in this project emphasizes that this transaction was in the nature of an adjustment to its capital structure, and did not resemble the mere acquisition of an asset for use in the business.

The acquisitions of the treasury stock in 1949 and 1950 thus had their genesis in specific projects which do not suggest that Colt's was dealing in its shares in the manner prescribed by the Treasury Regulation for taxability. It might be said, however, that the taxpayer held the stock, once purchased, for broader objectives since the directors and stockholders had resolved (under the authorization of the amended charter) that the acquired shares could be held, sold, exchanged, transferred, or retired "from time to time, to such an extent, in such manner and upon such terms as the Directors may deem advisable." We do not regard this broad boiler-plate resolution as significant in view of our factual finding that in May 1950 Colt's had no specific plans to use the 124,827 shares then reacquired for

---

by means of these sales. It is not clear, in any event, to what extent this portion of *Air Reduction Co.* has survived *Anderson, Clayton*. G.C.M. 16651, which the Second Circuit specifically noted as dealing with similar sales to corporate officers (130 F. 2d at 148), has been revoked on the basis of *Anderson, Clayton*. See Rev. Rul. 60-328, 1960-2 Cum. Bull. 427.

any particular venture, plan, or purpose. The mere possibility that this block of stock could legally be used as an ordinary asset does not override the fact that in 1950 and 1951 it was not being so used and was not anticipated to be so used.[6]

We come, then, directly to the Jacob transaction in July 1951. The exchange of Colt's stock for the Jacob property was unrelated, as we have seen, to the purposes of the two acquisitions of stock in 1949 and 1950.[7] It was an isolated event, and formed no part of a general pattern of using treasury shares to purchase property or discharge obligations in lieu of cash or other property.[8] It was never repeated, and the remaining shares were shortly retired in accordance with the original design of the directors and stockholders. Nevertheless, the Government argues, to give treasury stock in exchange for property is simply to substitute the shares for cash (or another marketable commodity) and therefore must necessarily be to deal with the shares as an ordinary asset. But we do not believe that every use of treasury shares to purchase property automatically falls into that class. If that were true, the specific limitation of the Treasury Regulation—that the firm must be dealing with its own shares "as it might in the shares of another"—would be inoperative for all such exchanges, regardless of the particular facts or "the real nature of the transaction." The Regulation expressly directs, how-

---

[6] In the context of the issue with which it was dealing, the Second Circuit agrees that the treasury stock was not acquired as an asset and not held as such. *Colt's Manufacturing Co.* v. *Commissioner*, *supra*, slip op. at 3041-42.

[7] The Second Circuit has reached the same conclusion in its *Colt's Manufacturing Co.* case, *supra*, slip op. at 3041.

[8] See *Commissioner* v. *Air Reduction Co.*, *supra*, 130 F. 2d at 146, 148 (C.A. 2), in which the taxpayer had previously bought the same type of property making payment partly in cash and partly in treasury shares.

ever, that the individual circumstances and the true character of the transaction must not be overlooked.

Here, for instance, we have the unusual element that the original negotiations for the Jacob assets were in terms of a cash payment and the change to a partial-stock transaction was made at the suggestion and for the convenience of the Jacob interests, who apparently wished to acquire a proprietary connection with the company they were about to join. This uncommon factor, combined with the isolated character of the transaction and the absence of any plan on the part of Colt's to use treasury stock to make purchases or fulfill its obligations, confirms to us that the corporation was not treating its own shares like those of another company or as the equivalent of cash or some other normal asset. Rather, the treasury stock was used for the special end of tieing the Jacob people to Colt's—an intracorporate purpose which would not be satisfied by cash or other property. See *Anderson, Clayton & Co.* v. *United States*, *supra*, 129 Ct. Cl. at 302-03, 122 F. Supp. at 842. The fact that treasury shares were used, instead of unissued stock, seems to have been due to nothing more than the coincidence that sufficient reacquired shares were lodged at that moment in the company's treasury.[9]

Our conclusion that the Jacob exchange did not lead to taxable gain is consistent, as we have already indicated, with *General Electric Co.* v. *United States*, *supra*, No. 145-59, Ct. Cl., decided March 7, 1962, 299 F. 2d 942. Neither the acquisition nor the disposition of General Electric's treasury shares is comparable to the taxpayer's. General Electric received a large portion of its stock, on liquidation of its subsidiary, in return for the latter's stock held by the parent; this transaction was deemed covered by the part of the Treasury Regulation specifically providing that "if the corporation receives its own stock as consideration upon the

[9] Colt's then president (Graham H. Anthony) testified that the treasury stock "was available, so we used it."

sale of property by it" the gain or loss must be taken into account. The other major difference between the cases is that General Electric regularly used its own stock to satisfy recurring needs. The shares not received through liquidation were deliberately acquired in order to fulfill the obligations of the parent company and its affiliates under various employee compensation plans and for charitable contributions (which could have been satisfied in cash, at least partially)—and treasury shares were regularly disposed of for those purposes under what was in effect a continuing program. On these findings, the court concluded that General Electric "was engaged in the enterprise of acquiring [its own stock] for the purpose of using it in the discharge of its obligations, in lieu of the payment of them in cash or using other stock to discharge them"; and that it actually and regularly used the shares so acquired in lieu of cash or stock in other corporations. That pattern and those circumstances do not exist in Colt's case.

The second issue is whether the treasury stock should be considered, in computing the taxpayer's excess profits tax credit for 1951 under the invested capital method, to be an asset within Section 437 of the 1939 Code (as well as an inadmissible asset under Section 440). Section 437(c) provided that the "equity capital of the taxpayer as of any time shall be the total of its assets held at such time in good faith for the purposes of the business, reduced by the total of its liabilities at such time." In passing upon this same question in connection with the tax for 1952, the Second Circuit has held that Colt's treasury stock was not an "asset" under this provision and was not held in good faith for the purposes of the business. *Colt's Manufacturing Co.* v. *Commissioner, supra*, No. 27250, C.A. 2, decided August 20, 1962. We concur with those rulings.

None of the treasury shares, as we have shown in discussing the first issue, was acquired for investment or productive use or general purposes; and the great majority (124,827 out of 128,927) were not even acquired for a pur-

pose directly connected with the carrying on of the business. There was no intention, at the inception of the purchase programs or thereafter, to use this block of stock as cash or other property would be used. And in fact the shares were not dealt with by the company as a business asset or as property; except for those transferred to the Jacob group, the stock was retired in 1952. The Jacob transaction, as we have noted, was isolated, unforeseen, and primarily motivated by the interests of the other party; even if those 8,927 shares could conceivably be viewed as assets under Section 437, the other 120,000 shares would still be unaffected.

Moreover, as the Second Circuit also suggested, the high proportion of treasury shares—128,927 out of a total of 200,000 issued (some 60%)—strongly indicates that this stock was not an asset but rather served, in substance, to reduce the company's equity capital. This result was officially recognized at the end of 1952 when the remaining 120,000 shares were formally retired. Although the accounting profession may not be wholly uniform in all of its views on the treatment of treasury shares, there appears to be agreement that a very large dormant segment of treasury shares, such as that held by Colt's in 1950 and 1951, should not be considered an asset.[10]

For these reasons, the plaintiff is entitled to recover on both issues, with interest as provided by law, and judgment will be entered to that effect. The amount of recovery will be determined pursuant to Rule 38(c).

It is so ordered.

DURFEE, *Judge;* LARAMORE, *Judge;* WHITAKER, *Judge;* and JONES, *Chief Judge,* concur.

---

[10] Since the plaintiff must prevail if the treasury stock was not an asset held in good faith for the purposes of the business, within the meaning of Section 437, we need not decide whether the stock was also an inadmissible asset under Section 440.